

Message Text

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ACTION EA-07

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P 080900Z OCT 74

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC PRIORITY 5124

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EO 11652 NA

TAGS EGEN JA

SUBJ: PRESIDENTIAL VISIT BACKGROUND PAPER V: STATUS OF THE
JAPANESE ECONOMY

1. JAPANESE ECONOMY IS EXPERIENCING STAGFLATION SIMILAR TO OTHER MAJOR INDUSTRIALIZED COUNTRIES BUT WITH HIGHER RATE OF INFLATION AND MORE PRECIPITATE DECLINE IN TOTAL OUTPUT THAN OTHERS WITH POSSIBLE EXCEPTION OF ITALY AND UK. EARLIER DEMAND-PULL PERIOD OF INFLATION EXACERBATED BY BOTH OIL AND OTHER RAW MATERIAL PRICE HIKES NOW SHIFTING TO COST-PUSH INFLATION UNDER IMPACT OF SOARING WAGE INCREASES AND STAGNANT PRODUCTION. GOJ RELIANCE ON TIGHT MONETARY-FISCAL POLICY HAS BEEN EFFECTIVE IN RESTRAINING AGGREGATE DEMAND BUT HAS NOT BEEN NOTICEABLY EFFECTIVE IN BRINGING INFLATION UNDER CONTROL. TIGHT MONEY POLICY HAS ALSO AFFECTED EXTERNAL ACCOUNTS BY DAPENING IMPORTS AND PROVIDING NATURAL INCENTIVE FOR PRIVATE FIRMS TO PROMOTE EXPORTS WITHOUT FORMAL OR INFORMAL ADOPTION BY GOJ OF AN QTE EXPORT DRIVE. UNQTE. GOJ OVERALL BALANCE OF PAYMENTS REMAINS IN HEAVY DEFICIT BUT CURRENT ACCOUNT IMPROVING RAPIDLY AND MOVED INTO SURPLUS IN AUGUST FOR FIRST TIME IN EIGHT MONTHS AND OFFICIAL RESERVES HAVE INCREASED BY OVER \$1 BILLION THIS YEAR.

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DECLINE IN GNP

2. REAL GNP DECLINED SHARPLY IN FIRST QUARTER 1974 AND GAIN IN SECOND QUARTER UNDER ONE PERCENT WITH NO CONVINCING AGGREGATE DATA THUS FAR TO BE SURE BOTTOM HAS BEEN REACHED. EXPECTATIONS OF MOST OFFICIAL AND PRIVATE OBSERVERS THAT JAPAN WILL RECORD ZERO OR BELOW ZERO GROWTH FOR CY 74 AS WHOLE AND THAT RECOVERY LIKELY BE SLOW IN FIRST HALF '75 REPRESENTS SUDDEN DECLINE FOR AN ECONOMY WHICH HAS PREVIOUSLY ENJOYED PROLONGED PERIOD OF OVER 10 PERCENT GROWTH. DURING PAST FEW MONTHS, INDUSTRIAL PRODUCTION SLIGHTLY BELOW PREVIOUS YEAR, AND INVENTORY LEVELS HAVE CONTINUED TO RISE. IN AUGUST PRODUCER INVENTORIES OF FINISHED GOODS RELATIVE TO SHIPMENTS REACHED HIGHEST RATES IN HISTORY. INCREASES IN PLANT AND EQUIPMENT EXPENDITURES HAVE BEEN MATCHED BY INCREASED PRICES. ABOUT 12 PERCENT OF PLANT/EQUIPMENT OUTLAYS ARE FOR POLLUTION CONTROL WHICH RAISE COSTS WITHOUT PRODUCTIVITY GAIN. CONSUMER SPENDING REMAINS SLUGGISH DESPITE RECORD WAGE INCREASES THIS SPRING PLUS SUMMER BONUSES, INDICATING BOTH CONSUMER RESISTANCE TO HIGH PRICES AND PSYCHOLOGY OF CAUTION ABOUT NEAR-TERM FUTURE (I.E. SAVE RATHER THAN SPEND). BANKRUPTCIES ARE HITTING APPROXIMATELY 30 PERCENT MORE FIRMS THAN YEAR AGO. ALTHOUGH FAILURES MOSTLY SMALL FIRMS, BANKRUPTCIES INCLUDE SECOND LARGEST SUCH FIRM SINCE WORLD WAR II, AND LIABILITIES OF BANKRUPT FIRMS THUS FAR IN 1974 MORE THAN DOUBLE COMPARABLE FIGURE IN 1973.

INFLATION

3. INFLATION RATE CONTINUES AT LEVELS FAR ABOVE THAT IN OTHER DEVELOPED COUNTRIES. AUGUST WHOLESALE PRICE INDEX 30.4 PERCENT ABOVE YEAR EARLIER LEVEL, AND CONSUMER PRICE INDEX INCREASED 25.4 PERCENT. WHILE THERE ARE INDICATIONS THAT INCREASES HAVE MODERATED IN RECENT MONTHS -- OVER PAST SIX MONTHS WPI HAS INCREASED AT ANNUAL RATE OF 11.3 PERCENT AND BPI AT 15.6 PERCENT -- THERE HAVE BEEN SIZABLE RECENT PRICE INCREASES (32 PERCENT INCREASE IN CONSUMER RICE PRICE, OVER 50 PERCENT INCREASE IN UTILITY FEES, 25-50 PERCENT INCREASE IN LIMITED OFFICIAL USE

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URBAN TRANSPORTATION AND RAILWAY FEES, AND 30 PLUS PERCENT INCREASE IN WAGES LAST SPRING). EPA EXPECTS 2 PERCENT INCREASE IN CPI IN OCT/NOV DUE TO THESE INCREASES IN REGULATED PRICES AND HOPES CPI INCREASE BY MARCH 75 WILL BE KEPT DOWN TO 15-18 PERCENT RANGE IN ORDER AVOID WAGE INCREASE NEXT SPRING ABOVE THAT FIGURE.

AND EFFORTS TO CONTTOL

4. GOJ EFFORTS TO CONTROL INFLATION, WHICH DATE BACK TO EARLY 1973, PLACED HEAVY RELIANCE ON CREDIT RESTRAINTS TO CONTRACT AGGREGATE DEMAND. INSTRUMENTS HAVE BEEN LARGELY THOSE OF MONETARY POLICY AND, TO LESSER EXTENT, FISCAL POLICY AND RESTRICTIONS ON NEW CONSTRUCTION. AS INDICATED ABOVE, THESE HAVE HAD ONLY LIMITED SUCCESS AT BEST IN RETARDING PRICE-WAGE ADVANCES AND HAVE AT SAME TIME DEEPENED ECONOMIC SLOWDOWN. GOJ POLICYMAKERS HAVE REITERATED THEIR INTENTION TO CONTINUE POLICY OF CURBING DEMAND, POSSIBLY INTO MID-1975. IN COMING WEEKS, NEXT YEAR'S BUDGET AND FUTURE ECONOMIC POLICY WILL BE DEBATED WITHIN CABINET AND LDP. VOICES ARE BEING RAISED THAT DEMAND-CURBING MEASURES ALONE NOT SUFFICIENT TO CONTAIN ALL INFLATIONARY PRESSURES, WHICH

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NOW INCLUDE STRONG COST-PUSH ELEMENTS. HOWEVER, NO COHERENT ALTERNATIVE STRATEGY HAS BEEN FORMULATED OR PROPOSED BY CRITICS OF PRESENT POLICIES. INCOMES POLICY, ONCE TABOO IN PUBLIC DISCUSSION, IS NOW INCREASINGLY ALLUDED TO, BUT LITTLE IMMEDIATE PROSPECT FOR WAGE AND/OR PRICE CONTROLS EXISTS. BUSINESS COMMUNITY, WHILE ACCEPTING BASIC GOJ POLICY, HAS BEEN PRESSING WITH SOME SUPPORT FROM MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI) FOR SELECTIVE RELIEF FROM DEMAND RESTRAINT FOR INDUSTRIES EXPERIENCING

SPECIAL DIFFICULTIES AND/OR PARTICULARLY IN NEED OF CAPACITY EXPANSION. SOME OF THESE DEMANDS ARE LIKELY TO BE MET.

EXPORTS AND BALANCE OF PAYMENTS

5. ONE BRIGHT SPOT, AN AREA WHICH JAPANESE HOPE WILL EVENTUALLY LEAD BUSINESS RECOVERY, IS EXPORTS. WHILE OIL IMPORT COSTS ESTIMATED TO SOAR FROM \$7 BILLION IN 1973 TO \$20 BILLION IN 1974, AND THUS IMPORT BILL HAS RISEN SHARPLY THIS YEAR, EXPORTS HAVE AT SAME TIME RISEN DRAMATICALLY. RECORD INCREASES IN EXPORTS IN JULY AND AUGUST OVER 1973 LEVELS, OUTSTRIPPING IMPORT INCREASES, LED JAPAN INTO MODEST SURPLUS IN TRADE AND CURRENT ACCOUNTS IN AUGUST, AND INDICATIONS ARE THAT THIS TREND WILL CONTINUED OFFICIAL USE

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TINUE AT LEAST FOR NEXT FEW MONTHS. NONETHELESS, JAPANESE REMAIN APPREHENSIVE ABOUT WEAKENING COMPETITIVE POSITION BECAUSE OF SHARPLY RISING LABOR AND OTHER COSTS AND ABOUT IMPACT OF DEPRESSED WORLD DEMAND ON PROSPECTS FOR CONTINUED EXPORT GROWTH.

6. JAPAN'S BALANCE OF PAYMENTS, SHARPLY IN DEFICIT IN 1973, HAS REMAINED IN THE RED DURING 1974, ALTHOUGH AT SOMEWHAT LESSER LEVELS, BECAUSE OF CONTINUING DEFICIT ON CAPITAL ACCOUNT. FOR THAT REASON, GOJ HHAS TAKEN STEPS TO ENCOURAGE CAPITAL INFLOW, AND RECENTLY HAS WORKED TO OBTAIN OIL DOLLARS FROM OIL PRODUCING COUNTRIES, WITH SOME SUCCESS. DESPITE PAYMENTS DEFICIT, JAPAN'S OFFICIEL FOREIGN EXCHANGE RESERVES HAVE REMAINED IN \$11-13 BILLION RANGE PLUS AN ESTIMATED \$9 BILLION OF FOREIGN ASSETS HELD OUTSIDE OFFICIAL RESERVES, WHICH PROVIDE JAPAN WITH COMFORTABLE CUSHION FOR NEAR FUTURE.
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